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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1941

**No. 286**

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*v.*

SOUTHWEST CONSOLIDATED CORPORATION,
*Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

## PETITION FOR REHEARING

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## PETITION FOR REHEARING

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TO THE HONORABLE JUSTICES OF THE UNITED STATES SUPREME COURT:

Respondent respectfully prays for a rehearing of this case, decided February 2, 1942, for the following reasons:

1. The Court held that basis was not cost to the old company because the transaction did not qualify as a "reorganization" under Sec. 112 (g) (1) of the 1934 Revenue Act. On February 9, 1942 the Court denied certiorari in the cases of *Commissioner* v. *Cement Investors, Inc.* and others, Nos. 644-646. In those cases the Tenth Circuit had held that a plan similar to the one here (although there income bonds as well as warrants were issued by the new company) *was* a "reorganization" under Sec. 112 (g) (1) of the 1936 Revenue Act. That statute is identical with the statute applicable here.

Presumably, the Court denied certiorari because the Tenth Circuit also found that the old bondholders had no recognizable gain or loss under Sec. 112 (b) (5) of the 1936 Act. That is, it is to be inferred this Court considered it unnecessary to pass on the *Cement Investors* and related cases because, while this Court presumably thought there was no "reorganization" there, this Court also thought the bondholders there had no gain or loss under Sec. 112 (b) (5), as the Circuit Court had concluded.

This approach makes it necessary, we submit, for the Court to reconsider its decision in this case because, if Sec. 112 (b) (5) is applicable to the exchange by the bondholders, under Sec. 113 (a) (8) of the 1934 Act the basis of the new company here is the cost to the old company, *and the decision of the Fifth Circuit should have been affirmed.*

In the *Cement Investors* and related cases the Commissioner claimed Sec. 112 (b) (5) was not applicable.[1] Likewise, the Commissioner claimed that Sec. 112 (b) (5) and the correlative basis provision, Sec. 113 (a) (8), was not applicable here.[2] The Commissioner's position on this point in this case is unsound for the following reasons:

Sec. 113 (a) (8) provides that if property is acquired by a corporation "in connection with a transaction described in Sec. 112 (b) (5)," then the basis shall be the same as it would be in the hands of the transferor. The taxpayer here acquired its assets "in connection with" the exchange by the bondholders, other claim-holders and stockholders of the old company of their old securities for the stock and stock purchase warrants of the taxpayer. The Tenth Circuit in the *Cement Investors* case found such a transaction to be within Sec. 112 (b) (5). If so, the

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[1] See the Commissioner's Petition for Certiorari in those cases.

[2] See Brief for Petitioner in No. 286, at page 24.

taxpayer here acquired its assets "in connection with a transaction described in Sec. 112 (b) (5)," and under Sec. 113 (a) (8) the basis of the taxpayer is the same as it would be in the hands of the "transferor." This Court found that the separate steps of the plan here are to be disregarded and the plan is to be treated as a single reorganization. So considered, the "transferor" was the old company. See *George A. Whittell & Co., Inc.*, 34 B. T. A. 1070.

The Board and the courts, in upholding the Commissioner, have similarly interpreted the corresponding term "in connection with a reorganization" contained in Section 113 (a) (7). *Piedmont Financial Company, Inc.*, 26 B. T. A. 1221.[3] In that case corporation A acquired all of the stock of corporation B (which was a "reorganization"), and subsequently liquidated B. The question was the basis to A for B's assets. The Board held that under Sec. 204 (a) (7) of the 1926 Revenue Act (corresponding to Sec. 113 (a) (7) of the 1934 Revenue Act) A's cost was the same as cost to B, saying (p. 1224):

> "* * * section 204 (a) (7) is not limited to property acquired in a tax-free reorganization, but includes property 'acquired in connection with a reorganization.'"

Likewise, if property is "acquired in connection with a transaction described in section 112 (b) (5)," basis is cost to transferor under Sec. 113 (a) (8).

Therefore, on the basis of the Tenth Circuit's decision in the *Cement Investors* case, which this Court has not

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[3] Cases to the same effect are *Monte & Co.*, 24 B. T. A. 401; *Flushing Nurseries Co.*, 25 B. T. A. 938; *Ahles Realty Corp.*, B. T. A. Memo., Dec. 28, 1932, aff'd. (C. C. A. 2) 71 F. (2d) 150, certiorari denied, 293 U. S. 611.

reversed; this Court should have affirmed the Fifth Circuit's decision here.[4]

2. The denial of certiorari in the *Cement Investors* and related cases, following the decision in this case, has created the utmost confusion as to what is the law in these matters. There is set forth in the Appendix an article appearing in "The Wall Street Journal," February 10, 1942, p. 2, which illustrates the doubt and uncertainty which have been created. Numerous companies are left in a quandary as to their tax position. It is impossible to determine the tax status of many pending and recently completed railroad reorganizations.[5] There is the most

[4] On February 9, 1942 the Court also denied certiorari in *Helvering* v. *New Haven & Shore Line Railway Co., Inc.*, No. 780. Such action would seem to be explicable only on the basis of some peculiarity in that record. There, as here, some of the bondholders did not participate in the plan and were paid off in cash. The Court in this case found that was enough to take the transaction out of the B definition of "reorganization". As the matter now stands, most attorneys, in all probability, will find it wholly impossible to reconcile the decision in this case with the denial of certiorari in the *New Haven* case. See Appendix.

[5] See "The Wall Street Journal," Feb. 3, 1942, p. 2; Feb. 4, 1942, p. 5; "The New York Times," Feb. 4, 1942, p. 27.

In "Outlook for the Security Markets," February 16, 1942, p. 928 (published by Standard & Poor's Corporation), appears the following:

> "Defaulted rail bonds showed some improvement following Supreme Court action on appeal in a corporate reorganization case suggesting that railroads which reorganized under section 77 could use their predecessor companies' invested capital as a base for calculating excess profits tax exemption. The action was in the form of a refusal to review a Court of Appeals decision and was without opinion; since it has previously taken action which might suggest the opposite conclusion, the issue remains to be clarified by a specific railroad reorganization case or a full opinion."

urgent need for clarification, and to that end a rehearing should be granted. The situation is truly important and transcends any considerations against granting a rehearing which might exist in the ordinary case.

3. The positions taken by the Court in the opinion rendered (1) that the plan should be treated as unitary and (2) that the statute should be given a strict literal interpretation, bring the decision here in conflict with a line of recent decisions of this Court.

The Court has held that where the assets of one corporation are transferred to another in consideration for a payment by the transferee directly to the owners of the transferor, for tax purposes such consideration is deemed to pass through the transferor corporation. *United States* v. *Joliet & Chicago Railroad Co.*, decided January 19, 1942; *United States* v. *Boston & Maine R. Co.*, 279 U. S. 732. And if, as here, the consideration is stock of the transferee, there is a stock transfer tax on a transfer of the right to receive such stock from the transferor corporation to its stockholders. *Raybestos-Manhattan, Inc.* v. *United States*, 296 U. S. 60.

Thus, under the decision rendered in this case and the above line of cases, the stock and warrants of the taxpayer here must be deemed to have gone, *first*, to the old corporation, and *thereafter* to have been distributed by it to its bondholders, claim-holders and stockholders, in accordance with the plan.

The result is that the transaction qualifies under the C definition of a "reorganization" in Sec. 112 (g) (1), since "*immediately* after the transfer the transferor" corporation owned all of the stock of the taxpayer, and therefore was "in control" of the taxpayer.

A strict interpretation of the word "immediately" in the C definition is required by the Court's decision. The Court has found that the word "solely" in the B definition "leaves no leeway." The rule of interpretation applied to one definition should likewise be applied to the other.

4. The Court found that the E definition of "reorganization" was inapplicable, on the theory that the transaction shifted "the ownership of the proprietary interest." But in the *Alabama Asphaltic* case the Court said that "for practical purposes" the shift took place "not later than the time when the creditors took steps to enforce their demands." Further:

> "When the equity owners are excluded and the old creditors become the stockholders of the new corporation, it conforms to realities to date their equity ownership from the time when they invoked the processes of the law to enforce their rights of full priority. At that time they stepped into the shoes of the old stockholders. The sale 'did nothing but recognize officially what had before been true in fact.' *Helvering* v. *New Haven & S. L. R. Co.*, 121 F. (2d) 985, 987."

We earnestly submit that if "for practical purposes" the situation after the transfer to the new company was the same as it was immediately before the transfer, and if the plan merely gave legal effect to "what had before been true in fact" then, consistently, the transaction was "a mere change in identity, form, or place of organization," as provided in E. The E definition reflects the fundamental principle that in tax matters substance and not form controls. The application of such principle in the interpretation of the E definition is particularly apt.

WHEREFORE, it is prayed that the Court grant a rehearing of this case.

Respectfully submitted,

A. CHAUNCEY NEWLIN,
FRED SIMON,
Attorneys for Respondent.

I certify that this petition is presented in good faith and not for delay.

A. CHAUNCEY NEWLIN,
Attorney for Respondent.

February 1942.

## Appendix

From "The Wall Street Journal", February 10, 1942, p. 2.

"Top-Notch Lawyers Paw the Air After More Supreme Court Rulings on Taxability of Reorganized Firms.

"By Eugene S. Duffield
"Staff Correspondent of The Wall Street Journal

"Washington—The Supreme Court yesterday left in a fog the taxability of companies which have been reorganized.

"Through this fog gleams one dim hope that railroads and other companies which have been reorganized under Section 77 of the Bankruptcy Act may be treated for tax purposes more leniently than companies which have passed through receivership and foreclosure sales.

"If railroads going through the Section 77 process are recognized as 'reorganized' companies under tax law definitions, they can use the property valuations of their predecessor companies for tax computations, thus obtaining larger deductions for depreciation and for excess profits tax purposes.

"However, the only certainty yesterday was that tax lawyers in and out of the government were completely uncertain about the court's application of tax laws to corporate reorganizations.

"In the past eight days the Supreme Court has handed down four opinions and five orders, all in answer to the single question: When is a corporation 'reorganized' within the meaning of the tax laws?

*"Court May Be Asked for Clarification*

"The usual result of Supreme Court decisions—in fact, the chief purpose for which litigants seek them—is clarification of the law. Yet these nine actions by the court on

the taxability of reorganized companies have left top-notch lawyers pawing the air. Nobody agrees on what the court has done or why it has done it. Indications are that the Government will ask the court to explain itself.

"*Some Case Histories*

"A recital of the facts in three of the nine cases, all of which involve the definition of 'reorganized' companies contained in Section 112 (G) of the revenue laws, shows why tax lawyers are confused. Here are the facts in one case:

"1. The predecessor of Southwest Consolidated Corp. defaulted on its bonds. Receivers were appointed. After a plan of reorganization had been worked out, the company's assets were sold at foreclosure sale to the bondholders protective committee.

"2. In exchange for these assets, the bondholders of the old company received the voting stock of the new Southwest Consolidated Corp.

"3. The stockholders of the old company received nothing but warrants permitting them to purchase stock in the new company.

"This is not a reorganization under any of the definitions of Section 112 (G) of the revenue laws, says the court. So far, so good. Now here are the facts in a second case:

"1. The predecessor company, Colorado Industrial Co. defaulted on its bonds and filed a petition for reorganization under Section 77B of the Bankruptcy Act.

"2. Under the reorganization plan bondholders in the old company received income bonds and voting stock in a new company.

"3. The stockholders in the old company received nothing but warrants permitting them to purchase stock in the new company.

"This *is* a reorganization within Section 112 (G) of the revenue act, said a majority of the Tenth Circuit Court, and yesterday the Supreme Court declined to review the circuit court's opinion.

"*There's a Difference But—*

"How does it differ from the Southwest case? There is one obvious difference. The second case (known as the Cement Investors Case) came under section 77B whereas the Southwest case did not. Some lawyers believed that single point made all the difference. Other lawyers said flatly that they thought it made no difference.

"One lynx-eyed barrister pointed out that the Circuit Court had upheld the second case under Section 112 (B)(5) as well as Section 112 (G) of the Revenue Act. He surmised that the Supreme Court had agreed with the lower court on the Section 112 (B) (5) angle—which was not involved in the Southwest case—but had not agreed on the Section 112 (G) point.

"'O, no,' objected another lawyer, 'if they were going to do anything as subtle as that, they would write an opinion about it.'

"*Now Mystery Deepens*

"At least there is room for argument over why these two cases should be decided differently. But now the mystery deepens. Look again at the facts in the Southwest case, and remember that the Court held these facts do not constitute a reorganization under the revenue acts. Now check these facts against the following facts in a third case:

"1. The New Haven & Shore Line Railway defaulted on its bonds. Receivers were appointed. After a plan of reorganization had been worked out, the old company's assets were sold at foreclosure sale to the bondholders protective committee.

"2. In exchange for these assets, the bondholders of the old company received the capital stock of the new company.

"3. The stockholders of the old company received nothing—a fact which everyone concedes makes no difference.

"The Circuit Court held that this *is* a reorganization under the definitions in Section 112 (G) of the Revenue Act, and the Supreme Court yesterday refused to review this decision. How does this differ from the Southwest case? The Court did not say.

"Lovers of mysteries are free to puzzle over these three cases until the Court deigns to speak again—and more clearly."